

Message Text

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PAGE 01 MADRID 04669 01 OF 02 021353Z
ACTION EUR-12

INFO OCT-01 ISO-00 SSO-00 NSCE-00 ICAE-00 INRE-00
SP-02 AID-05 EB-08 TRSE-00 SS-15 STR-07 OMB-01
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FM AMEMBASSY MADRID
TO AMEMBASSY PARIS IMMEDIATE
SECSTATE WASHDC IMMEDIATE 4414

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PARIS ALSO FOR USOECD

USOECD PLEASE PASS TO KENT GOODSPEED, ECON COUNSELOR
FROM MADRID

E.O. 11652: N/A
TAGS: OECD, ECON, SP
SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE
(EDRC): REVIEW OF SPAIN, MAY 3

REF: PARIS 13837

1. SECRETARIAT'S DRAFT REPORT APPEARS TO GIVE A FULL AND
ACCURATE DESCRIPTION OF HOW SPAIN GOT INTO SUCH DEEP
ECONOMIC TROUBLE, AND WHAT IT HAS BEEN DOING IN THE PAST
NINE MONTHS TO WORK ITS WAY CLEAR.

2. IN THE MAIN WE AGREE WITH THE SECRETARIAT'S CON-
CLUSIONS AND FORECASTS FOR THE REST OF 1978. WE HAVE
SOME PROBLEMS THOUGH ON THE KEY QUESTION OF WAGE LEVELS
AND THE SECRETARIAT'S RECOMMENDATION THAT THE MONCLOA
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PAGE 02 MADRID 04669 01 OF 02 021353Z

PACT'S RESTRICTIONS ON REAL WAGE INCREASES BE RELAXED
TO STIMULATE DOMESTIC DEMAND.

3. THE MONCLOA PACT'S TARGET OF 17 PERCENT INFLATION
IN THE CONSUMER PRICE INDEX FOR 1978 AND 22 PERCENT
AVERAGE INCREASE IN WAGES ALREADY ALLOWS FOR SOME WAGE
GROWTH IN REAL TERMS. IN OUR VIEW, THERE IS A LONG

WAY YET TO GO IN ORDER TO WRING SEVERAL YEARS OF INFLATIONARY PSYCHOLOGY OUT OF THE SPANISH ECONOMY AND PUT IT ON A SOUND FOOTING FOR THE FUTURE. THE MONCLOA PACTS ARE A CAREFULLY BALANCED COLLECTION OF POLICIES. THEY WERE ACCEPTED BY ALL POLITICAL PARTIES BECAUSE OF THE BELIEF THAT ALL ELEMENTS OF THE ECONOMY, BUSINESS, LABOR, BANKS AND THE GOVERNMENT WOULD HAVE TO SUFFER EQUALLY IF A MORE COMPETITIVE AND EFFICIENT MARKET ECONOMY SYSTEM WAS TO BE ESTABLISHED. TRUE, LABOR IS PAYING A COST. BUT BUSINESS IS ALSO TAKING A BEATING. WE DO NOT BELIEVE THAT PRIVATE INVESTMENT, WHICH (TO A MUCH GREATER EXTENT THAN IN THE OTHER OECD COUNTRIES) IS THE KEY TO SPANISH ECONOMIC GROWTH, WILL BEGIN TO PICK UP AGAIN UNTIL THE PRIVATE SECTOR, BOTH DOMESTIC AND FOREIGN, IS SHOWN CONTINUED PROOF THAT THE GOVERNMENT CAN STICK TO ITS LONG TERM COMMITMENTS. THESE INCLUDE A WORKABLE CONSTITUTION WHICH YIELDS A REASONABLY STABLE POLITICAL SYSTEM; A CLEAR IDEA OF WHERE THE TAX REFORM PROPOSALS WILL END UP; AND A DEFINITE BREAK WITH DOUBLE DIGIT INFLATION THAT HAS PLAGUED SPAIN FOR THE LAST FEW YEARS.

4. THE SPANISH GOVERNMENT IS ALREADY UNDER CONSIDERABLE AND GROWING PRESSURE TO EASE UP. THIS WILL CERTAINLY INCREASE AS MUNICIPAL AND THE NATIONAL ELECTIONS DRAW CLOSER. BUSINESS WANTS TAX REFORM AND THE IMPARTIAL LIMITED OFFICIAL USE

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PAGE 03 MADRID 04669 01 OF 02 021353Z

ALLOCATION OF CREDIT TO THE MOST EFFICIENT USERS (DOING AWAY WITH THE INVESTMENT COEFFICIENT SCHEME) TO BE SLOWED UP. LABOR WANTS HIGHER WAGES, EVEN MORE JOB SECURITY AND A POWERFUL ROLE IN MANAGEMENT DECISION MAKING. (THIS LAST ISSUE IS NOW BEING FOUGHT OUT IN PARLIAMNT AND HAS THE BUSINESS COMMUNITY EVEN MORE APPREHENSIVE ABOUT THE FUTURE.)

5. WE WOULD SUGGEST THAT US/OECD SEEK TO HAVE THE REVIEW MEETING BRACE THE SPANISH GOVERNMENT'S RESOLVE TO KEEP THE CRUCIAL MID TO LONG TERM OBJECTIVES FIRMLY IN MIND. CONTROL OF INFLATION TO RESTORE INVESTOR CONFIDENCE AND OVERALL STRUCTURAL REFORM APPEAR TO US TO BE THE CRITICAL CONSIDERATIONS, RATHER THAN AN EASING OF WAGE RESTRICTIONS WHICH COULD REKINDLE INFLATION AND FURTHER STIFLE NEW INVESTMENT.

6. SOME SUGGESTIONS TO STIMULATE INVESTMENT:

-- SOCIAL SECURITY COSTS ARE OVER 40 PERCENT AND ARE ALL BORNE BY THE EMPLOYER. THE GOVERNMENT COULD PICK UP A CONSIDERABLY LARGER SHARE OF THIS BURDEN; IN TURN FOR

BUSINESS SUPPORT OF THE NEW, MORE PROGRESSIVE, AND
HIGHER TAX STRUCTURE; WHILE HOLDING FIRM FOR A WHILE
LONGER ON REAL WAGES. THIS WOULD FREE UP ADDITIONAL
CAPITAL FOR INVESTMENTS.

-- A SYSTEM OF INVESTMENT TAX CREDITS WOULD ALSO HELP.

-- THE GOVERNMENT COULD MOVE UP ALREADY BUDGETED BUT
SLOW TO BE COMMITTED CAPITAL EXPENDITURES IN KEY SECTORS.
THIS WOULD STIMULATE DEMAND SOMEWHAT AND GIVE A BOOST
TO INVESTMENT IN SUPPORTING INDUSTRIES.

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PAGE 01 MADRID 04669 02 OF 02 021358Z
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USOECD PLEASE PASS TO KENT GOODSPEED, ECON COUNSELOR
FROM MADRID

-- THE GOVERNMENT COULD GIVE GREATER ATTENTION TO
ESTABLISHING A WORKING SECONDARY MONEY MARKET. MONETARY
POLICY WHICH IS THE GOVERNMENT'S MAIN MACRO TOOL IS
CONFINED TO THE RAW AMOUNT OF SHORT TERM CREDIT MADE
AVAILABLE TO THE BANKS, TO TAKE OR LEAVE AS THEY SEE FIT.
THIS HAS RESULTED IN SOME VERY SEVERE SWINGS IN SHORT
TERM MARKET RATES; FROM A LONG PERIOD OF LOW COST, EASY
MONEY WHICH PROPPED UP INEFFICIENT INDUSTRIES UP TO
MID-1977, TO THE TIGHT MONEY SITUATION OF LAST OCTOBER-
DECEMBER WHICH SENT OVERNIGHT RATES UP TO ABOUT 20
PERCENT AND DROVE SOME BANKS AND BUSINESSES AGAINST

THE WALL. RATES HAVE EASED CONSIDERABLY NOW (8-9 PERCENT)
AND MONEY IS READILY AVAILABLE BUT THERE ARE FEW TAKERS.
STABLER

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